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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

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FEDERAL COMMUNICATIONS COMMISSION
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In the Matter of	)	
	)	
1993 Annual Access Tariff Filings	)	CC Dkt. No. 93-193
	)	

AMERITECH RESPONSE TO OPPOSITIONS TO DIRECT CASE

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SUMMARY

The Ameritech Operating Companies (Ameritech), pursuant to the Federal Communications Commission's (Commission) *June 23 Order*, respond to the Oppositions to its Direct Case filed in the above captioned proceeding. Despite the arguments presented in the Oppositions, no party has provided information sufficient to justify changing Ameritech's rates as filed in its annual tariff filing on April 2, 1993.

Specifically, in this filing and in Ameritech's previous filings, Ameritech has shown that it does not control the costs for that portion of the TBO related to current retirees, thereby the recognition of those costs pursuant to the implementation of SFAS No. 106 meets the first criteria for exogenous treatment.

In addition, for the purposes of this proceeding, it is abundantly clear that the add back of sharing amounts in determining base year earnings was neither required nor permitted by the Commission's rules. The fact that Ameritech did not add back those amounts cannot be found to constitute a reason for rejecting the tariff at hand. To do so would constitute a retroactive change in the Commission's rules violating the Administrative Procedures Act.

Moreover, LIDB is properly placed in the local transport category and should not be put in separate banding requirements. Finally, no commenting party took issue with the manner in which Ameritech calculated PCI and rate changes to implement the reallocation of general support facility ("GSF") costs, and therefore the rates should be allowed to become effective as filed.

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The Ameritech Operating Companies (Ameritech),[1] pursuant to the Federal Communications Commission's (Commission) *June 23 Order*,[2] respond to the Oppositions to its Direct Case filed in the above captioned proceeding. Despite the arguments presented in the Oppositions, no party has provided information sufficient to justify changing Ameritech's rates as filed in its annual tariff filing on April 2, 1993. Consequently, the Commission should reject the Oppositions[3] and allow Ameritech's rates to become effective as filed.

I. Ameritech Has Demonstrated That Its SFAS No. 106 Costs Meet The Criteria For Exogenous Cost Treatment.

All four parties opposing Ameritech's Direct Case argue that the transitional benefit obligation (TBO) of other post employment benefit costs (OPEBS) associated with the implementation of SFAS No. 106 do not meet the

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[1] The Ameritech Operating Companies are: Illinois Bell Telephone Company, Indiana Bell Telephone Co., Inc., Michigan Bell Telephone Company, The Ohio Bell Telephone Company, and Wisconsin Bell, Inc.

[2] 1993 Annual Access Tariff Filings, CC Dkt. No. 93-193, Memorandum Opinion and Order Suspending Rates and Designating Issues for Investigation, DA 93-762, released June 23, 1993 (June 23 Order). The annual filing has been revised twice, once on May 2, 1993, regarding 800 database services, and again on June 17, 1993, regarding the allocation of general support facilities.

[3] Oppositions were filed by Ad Hoc Telecommunications Users Committee (Ad Hoc); Allnet Communication Services, Inc. (Allnet); American Telephone & Telegraph (AT&T); and MCI Communications, Inc. (MCI).

Commission criteria for exogenous cost treatment under price caps. Generally, these parties reiterate that Ameritech and the other local exchange carriers (LECs) have control over these costs and cannot guarantee that there will be no double counting of the costs.[4]

Once again, in arguing that Ameritech has control over the recognition of OPEB costs, opponents confuse the arguments about the amount of costs which should receive exogenous treatment with the arguments whether exogenous treatment should be granted at all. Specifically, opponents fail to recognize the limited nature of Ameritech's request, i.e., Ameritech requests exogenous treatment for only that portion of the TBO related to current retirees. Under SFAS No. 106, Ameritech is required to estimate the costs of offering benefits to these current retirees in the future (benefits which retirees received today) and accrue for those costs now. In fact, SFAS No. 106 states that Ameritech must estimate its TBO based on the historical and anticipated obligations of the company. And, because Ameritech plans on continuing to provide these benefits indefinitely, as noted in its Summary Plan descriptions, the cost of these benefits are properly included in the TBO.[5]

Moreover, as AT&T recognized, there are significant problems with suddenly rescinding the provision of these benefits to current retirees; and these problems are directly related to the issue of whether Ameritech has control over the recognition of those costs. Ameritech does not conduct business in a vacuum

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[4] See e.g., Allnet at 3-4; and AT&T at 11-12, and 13-19.

[5] See 1993 Annual Access Tariff Filings, CC Dkt. No. 91-193, Ameritech Response to Designated Issues for Investigation, CC Dkt. No. 93-193, at Attachment 2, Exhibit 1, Summary Plan Descriptions, filed July 27, 1993. MCI incorrectly argues that the CWA has already bargained for decreased wages by having employers agree to provide OPEBs to retirees, and therefore the costs of these benefits are already reflected in current rates. MCI at 5. However, that is not the case. As noted in Ameritech's Direct Case, the union negotiations do not effect retirees, only current employees, so there could not have been such an agreement. Ameritech Response at 3, note 4.

and must take into consideration the ethical, labor and public relation impacts of its decisions in running its business. Likewise, the Commission must consider what impacts its decision will have on LECs' incentives when determining whether granting exogenous treatment is in the public interest.

In this filing and in Ameritech's previous filings, Ameritech has shown that it does not control the costs for that portion of the TBO related to current retirees, thereby the recognition of those costs pursuant to the implementation of SFAS No. 106 meets the first criteria for exogenous treatment.

Furthermore, Ameritech has demonstrated with reasonable certainty that there will be no double counting under the price cap formula for that portion of the TBO for which Ameritech seeks exogenous treatment.[6] In this regard, Ameritech has shown that due to the timing difference between the Commission's prescription of a new rate of return in September 1990, and the Commission's stated change in its treatment of mandatory GAAP changes under price caps after that prescription in 1991; investors could not reasonably have required a greater rate of return based on the anticipated implementation of SFAS No. 106.[7] In addition, Ameritech has shown that the productivity factor which arguably includes a factor for the VEBA trust is not applicable to

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[6] Opponents argue that Ameritech must "guarantee" with "absolute accuracy" that there will be no double counting of OPEB costs if exogenous treatment under price caps is granted. Ad Hoc at 6-7; and Allnet at 4. However, the standard they argue Ameritech must meet is unreasonable, unworkable, and contrary to carrier initiated rates. Since LECs are required only to demonstrate that their rates are just and reasonable, then likewise LECs should only be required to demonstrate that its costs, even if result in an exogenous change, are reasonable. The Commission certainly does not require absolute accuracy when an exogenous change decreasing LECs' price caps is required.

[7] Ad Hoc argues that there must have been "some doubt" by investors about the treatment of OPEBs under price caps. Ad Hoc at 8. However, it provides no legitimate or factual basis for this speculation. Ameritech has shown that based on timing a reasonable investor would assume because of Commission statements that when the rate of return was prescribed, OPEBs would receive exogenous cost treatment. Absent some additional information from Ad Hoc, there is no basis in the record to support the finding that the rate of return includes some recognition that OPEBs would not receive exogenous treatment.

Ameritech's request for exogenous treatment, because Ameritech seeks exogenous treatment for only that portion of the TBO associated with current retirees, not active employees.[8]

With regard to intertemporal double counting, Ameritech demonstrated that based on its assumptions for future growth and the information provided in the Godwins Study, granting exogenous treatment for that portion of the TBO associated with current retirees will not result in double counting.[9] Finally, granting exogenous treatment for the limited costs requested by Ameritech will not undermine the polices of price caps. As noted above, Ameritech seeks exogenous cost treatment for the TBO associated with current retirees and therefore it has no ability to effect the recognition of this liability.

Based on the foregoing, Ameritech has demonstrated that pursuant to the implementation of SFAS No. 106, its recognition of that portion of the TBO costs associated with current retirees qualifies for exogenous treatment under price caps.

II. Prior Year's Sharing or Low End Adjustments Should Be Included in the Computation of Rates of Return for Determining the Current Year's Sharing and Low End Adjustments to Price Cap Indices.

Since this is a proceeding to determine whether LECs' rates are lawful, and since Ameritech's rates are governed by the Commission's price cap system, the question in this context is whether Ameritech's treatment of 1992 sharing in calculating the current year's sharing adjustment to its price cap indices violated the Commission's rules. Since the Commission's rules did not require -- and

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[8] 1993 Annual Access Tariff Filings, Ameritech Operating Companies, Transmittal No. 702, Description and Justification at 13-14.

[9] Treatment of Local Exchange Carrier Tariffs Implementing Statement of Financial Accounting Standards, CC Dkt. No. 92-101, Ameritech Operating Companies' Reply to Oppositions to their Direct Case, filed July 31, 1992, at 21.

arguably did not permit -- the add back of sharing amounts (or subtracting out of lower formula adjustment ("LFA") amounts) in determining base year earnings for sharing and LFA purposes, Ameritech's refusal to add sharing amounts back into base year earning calculations can not result in Ameritech's rates being deemed unlawful.

Ad Hoc is correct when it argues that the issue of "add back" is appropriately before the Commission in this context. However, the issue properly phrased is not whether add back should be required but rather whether add back is required or even permitted by the Commission's rules as they are currently written.

The Commission issued a Notice of Proposed Rulemaking to consider whether add back should be required.[10] In response to that notice, Ameritech has filed comments and reply comments indicating why add back should not be required on a going forward basis. However, the Commission's admission in the NPRM that

> this issue was neither expressly discussed in the LEC price cap orders nor clearly addressed in our Rules[11]

essentially disposes of the issue for the purposes of this proceeding. That is, the Commission's rules neither required nor permitted add back in the calculation of base year earnings for the purposes of determining the current year's sharing obligations and lower formula adjustments.[12]

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10 In the Matter of Price Cap Regulation of Local Exchange Carriers, Rate of Return Sharing and Lower Formula Adjustment, CC Docket No. 93-179, Notice of Proposed Rulemaking, FCC 93-325 (released July 6, 1993) ("NPRM").

11 Id. at ¶ 4.

12 If add back is neither permitted nor required, LECs are not permitted to manipulate add back and low end adjustment mechanisms to serve their own interests as feared by Ad Hoc. Ad Hoc at 14-15.

Nonetheless, commentors still argue that add back is required because, they claim, the Commission intended that price cap carrier rates of return would continue to be calculated and reported in essentially the same manner as they had been under rate of return regulation.[13] However, this argument misses two very fundamental points. First, under rate of return regulation, add back was required only for refunds of a prior year's excessive earnings. The Commission has made it abundantly clear that sharing under price caps is not the same as refunds under rate of return regulation:

> We believe that, where an incentive-based system can be designed to benefit both carriers and their customers, incentive-based regulation will produce greater benefits than adjustments to rate of return.[14]
>
> Price cap regulation is designed as a substitute for rate of return regulation...[15]
>
> The LECs are correct in asserting that the sharing adjustment does not imply unlawfulness, and does not constitute a penalty.[16]
>
> We also reject the argument that we cannot include interest unless we characterize the sharing adjustment as a refund of over-earnings.[17]

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[13] Ad Hoc at 20, Allnet at 5-6, MCI at 28.

[14] In the Matter of Policy and Rules Concerning Rates for Dominant Carriers, CC Docket No. 87-313, Second Report and Order, FCC 90-314 (released October 14, 1990) ("SRO") at ¶ 40.

[15] In the Matter of Policy and Rules Concerning Rates for Dominant Carriers, CC Docket No. 87-313, Second Further Notice of Proposed Rulemaking, FCC 89-91 (released April 17, 1989) ("SFNPRM") at ¶ 573.

[16] In the Matter of Policy and Rules Concerning Rates for Dominant Carriers, CC Docket No. 87-313, Order on Reconsideration, FCC 91-115 (released April 17, 1991) ("Reconsideration Order") at ¶ 102.

[17] Id. at ¶ 105.

> Sharing is intended as a means of sharing prospective productivity gains, and not a refund mechanism.[18]

Thus, the add back line on Form 492 that applies to refunds does not apply to sharing in the context of price cap regulation.

Second, after the implementation of price caps for local exchange carriers, the Common Carrier Bureau changed Form 492 for carriers subject to incentive regulation.[19] Under Form 492A, the "add back" calculation for determining base year rate of return was eliminated from the revised earnings report form for price cap LECs. Thus, as AT&T points out in its comments:

> [I]t is not credible to claim that the add back procedure is still contemplated by the Commission's existing price cap rules.[20]

Ad Hoc, however, continues to insist that add back is required to guard against effective earnings outside a reasonable range.[21] This is misguided. Under price caps, there is no maximum rate of return. Earnings over 16.25% (assuming a 3.3% total productivity offset) will be shared 100% in the next tariff year via reduction to a carrier's price <u>cap</u> (not necessarily to its rates), so that, in economic reality, even with add back, a carrier's rate of return after sharing may be well above 14.25%.

That is the essential difference between refunds under rate of return regulation and sharing under price cap regulation based on a forward looking adjustment to a carrier's productivity offset.

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18 Id. at ¶ n. 148.

19 See FCC submission to the OMB, OMB Number 3060-0355.

20 AT&T at 23.

21 Ad Hoc at 20-21.

On the other hand, MCI argues that failure to require add back understates base period earnings.[22] This, however, ignores economic reality. The assumption behind this view is the belief that, without add back, shareholders would make more money in the base year. In fact, however, add back involves an accounting fiction that raises only the apparent rate of return. The adjustment does not make shareholders any richer. It creates no additional funds in the base year that can be distributed to shareholders or reinvested in the business. Add back merely distorts the actual earnings of the price cap carrier -- giving them the appearance of being higher than they really are.

Finally, two of the commentors continue to insist that add back is appropriate for sharing but not for LFAs.[23] In support of this position, they attempt to show the similarity of sharing to refunds and the dissimilarity of LFAs to anything but a normal rate increase under rate of return regulation. However, this argument that exposes the logical inconsistency of requiring sharing to be treated like refunds. First, even though as noted above, the Commission itself has clearly indicated that sharing under price caps is not to be regarded the same as refunds under rate of return regulation, both commentors speak of sharing as if it were the refund of unlawful earnings.[24]

Simultaneously, because they do not favor add back for LFAs, these parties argue that the Commission should view LFAs like simple rate increases

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22 MCI at 29.

23 Ad Hoc at 21-24; MCI at 29-33.

24 See, e.g. Ad Hoc at 23 ("Without an add back requirement the sharing mechanism will have an unintended continuing impact on future year earnings by incorporating a refund of earnings made in the prior period into the revenue stream of the period under review." Emphasis added.); MCI at 27-28 ("[T] he Commission must treat sharing amounts like refunds...The only matter that has changed between rate of return and price cap regulation is the basis upon which prospective rates are set and the level (range) of earnings carrier are allowed to earn.").

(thus not requiring "add back").[25] Yet the Commission made it clear that LFAs were something very different from normal cost of service type rate increases. Specifically, the Commission noted that LFAs were not a mechanism to guarantee a rate of return and that, if a LEC found itself chronically underearning, it could file a regular rate increase.[26]

Sharing and LFAs are merely two sides of the same price cap coin. They were implemented as part of price cap regulation in order to allow for the fact that a single, industry-wide productivity offset was used for all price cap LECs and that this figure might be understated or overstated in the case of any single carrier.[27] Sharing does not constitute a refund of base year overearnings any more than LFAs constitute recoupment of base year underearnings. That fact requires that both sharing and LFAs be treated the same for add back purposes. Thus, the only logical approach is to permit the effects of both sharing and LFAs to be reflected in base year earnings calculations for determining current sharing and LFA amounts.

That, however, relates to the issue of whether the Commission's rule should be changed on a going forward basis. For the purposes of this proceeding, it is abundantly clear that the add back of sharing amounts in determining base year earnings was neither required nor permitted by the Commission's rules. The fact that Ameritech did not add back those amounts cannot be found to constitute a reason for rejecting the tariff at hand. To do so

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[25] Ad Hoc at 22 ("[T]he LFA is designed to retarget future rate of return."); MCI at 27-28 ("[T]he Commission must treat...LFAs like rate increases.").

[26] Reconsideration Order at ¶ 117.

[27] See Reconsideration Order at ¶ 86; SRO at ¶ 147.

would constitute a retroactive change in the Commission's rules violating the Administrative Procedures Act.[28]

III. LIDB Rates Are Appropriately In The Local Transport Category

Several parties challenge Ameritech's, and other LECs', decision to place LIDB rates in the local transport category alleging they should be in local switching.[29] One party also argues that LIDB should be placed in a new service category.[30] However, neither of these positions are reasonable. First, LIDB rates are appropriately placed in the local transport category because it corresponds to how LIDB investment is assigned. Under Part 32 of the Commission's rules, LIDB investment is recorded in Account 2212. The investment is then categorized as COE Category 2 - Tandem Switching in Part 36 of the rules. Then, under Part 69, Tandem Switching Investment is assigned to the local transport category. Therefore in order to maintain consistency between the assignment of investment and revenues, LIDB rates are properly placed in the local transport category.

Furthermore, there is no need to establish a new service category for LIDB rates. The purpose of price caps is to ensure reasonable prices to consumers through caps on prices, while giving LECs some pricing flexibility because of those caps. A different category for all new services would undermine the purpose and incentives of price caps and would serve only to continue a trend toward eliminating the minimal pricing flexibility granted the LECs in the original price cap order. The Commission recently proposed to place operator

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[28] 5 U.S.C. §553.

[29] See e.g., Ad Hoc at 25; and Allnet at 9.

[30] AT&T at 38.

services in a new service category, and has made similar decisions regarding other new services.[31] Placing all these services in their own bands threatens the achievement of one of the goals of the price cap order, *i.e.*, economically efficient pricing. In fact, there is substantial competition for LIDB through the credit cards provided by each of the interexchange carriers, for example, AT&T's Universal Card, which will provide additional protection to ensure reasonable prices. Thus, at a minimum, the Commission should not subject the LIDB rate elements to separate banding requirements other than the cap on the switched traffic sensitive basket.

IV. Ameritech Properly Reallocated GSF Costs In Accordance With The GSF Order.

No commenting party took issue with the manner in which Ameritech calculated PCI and rate changes to implement the reallocation of general support facility ("GSF") costs resulting from the Commission's Order in CC Docket No. 92-222.[32] Therefore, the Commission should specifically find that no showing has been made that the rates are unlawful in that respect.

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[31] See Treatment of Operator Services Under Price Cap Regulation, CC Dkt. No. 93-124, Comments of Ameritech filed on July 8, 1993.

[32] In the Matter of the Amendment of the Part 69 Allocation of General Support Facility Costs, CC Docket No. 92-222, Report and Order, FCC 93-238 (released May 19, 1993).

V. Conclusion

Based on the foregoing, Ameritech has demonstrated that its rates are just and reasonable and do not otherwise violated the Commission's rules. Therefore, the Commission should grant exogenous cost treatment for Ameritech's TBO and should allow its other rates to become effective as filed.

Respectfully submitted,

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CERTIFICATE OF SERVICE

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